IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF PUERTO RICO

DIONISIO TRIGO GONZÁLEZ and ANA RITA SUÁREZ SEÍN, individually and on behalf of all others similarly situated, and derivatively on behalf of FIRST PUERTO RICO TAX-EXEMPT TARGET MATURITY FUND II, INC.; FIRST PUERTO RICO TAX-EXEMPT TARGET MATURITY FUND III, INC.; FIRST PUERTO RICO TAX-EXEMPT TARGET MATURITY FUND IV, INC.; FIRST PUERTO RICO TARGET MATURITY FUND V, INC.; and FIRST PUERTO RICO TAX-EXEMPT TARGET MATURITY FUND VII, INC., Plaintiffs, v. BANCO SANTANDER, S.A.; SANTANDER BANCORP; BANCO SANTANDER PUERTO RICO; SANTANDER SECURITIES LLC; SANTANDER ASSET MANAGEMENT, LLC; JUAN CARLOS BATLLE; FRANCISCO JAVIER HIDALGO; LUIS ROIG; ROMÁN BLANCO; FREDY F. MOLFINO; FERNANDO L. BATLLE; MARIO F. GAZTAMBIDE; FRANCISCO MARRERO-MELÉNDEZ; JOSÉ E. VÁSQUEZ-BARQUET; and ANTONIO ARIAS III, Defendants, v. FIRST PUERTO RICO TAX-EXEMPT TARGET MATURITY FUND II, INC.; FIRST PUERTO RICO TAX-EXEMPT TARGET MATURITY FUND III, INC.; FIRST PUERTO RICO TAX-EXEMPT TARGET MATURITY FUND IV, INC.; FIRST PUERTO RICO TARGET MATURITY FUND V, INC.; and FIRST PUERTO RICO TAX-EXEMPT TARGET MATURITY FUND VII, INC., Nominal Defendants.	**Civil Action No. 3:16-02868**

DEFENDANTS' MEMORANDUM OF LAW
IN OPPOSITION TO PLAINTIFFS' MOTION TO REMAND

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TABLE OF CONTENTS

Page

PRELIMINARY STATEMENT 1

BACKGROUND 2

ARGUMENT 5

I. Defendants Have Satisfied the Requirements for CAFA Removal 5

II. Plaintiffs Bear the Burden of Proving that the "Local Controversy" Exception to CAFA Applies 6

III. Plaintiffs Have Failed to Prove that the "Local Controversy" Exception Applies . 8

CONCLUSION 11

TABLE OF AUTHORITIES

Cases **Page(s)**

Coll. of Dental Surgeons of Puerto Rico v. Triple S Mgmt., Inc.,
2011 WL 414991 (D.P.R. Feb. 8, 2011)....6, 7, 9, 10

Fernandez et al v. UBS AG et al.,
No. 15-cv-02859 (S.D.N.Y. April 14, 2015) 5

Kearns v. Ford Motor Co.,
2005 WL 3967998 (C.D.Cal. Nov. 21, 2005)....10

Marino v. Countrywide Fin. Corp.,
26 F. Supp. 3d 949 (C.D. Cal. 2014) 7, 10

Pirinea v. Ambac Fin. Grp., Inc. et al.,
No. 16-cv-05076 (S.D.N.Y. June 28, 2016) 5

Waller v. Hewlett–Packard Co.,
2011 WL 8601207 (S.D. Cal. May 10, 2011)....8

Statutes

Class Action Fairness Act of 2005, 28 U.S.C. § 1332(d) .... *passim*

TO THE HONORABLE COURT:

Defendants Banco Santander, S.A. ("BSSA"); Santander Bancorp ("BanCorp"); Banco Santander Puerto Rico, Santander Securities LLC ("Santander Securities"), Santander Asset Management, LLC ("SAM") (collectively, the "Santander Defendants"); Luis Roig; and Fredy Molfino, by and through their undersigned counsel, respectfully submit this memorandum of law in support of their opposition to Plaintiffs' Motion to Remand this action to the Commonwealth of Puerto Rico Court of First Instance, Superior Part of San Juan (Dkt. No. 13, the "Motion" or "Mot.").

PRELIMINARY STATEMENT

This Court has original jurisdiction over this action under the Class Action Fairness Act of 2005 ("CAFA"), Pub. L. No. 109-2, *codified in relevant part at* 28 U.S.C. § 1332(d). BSSA's Notice of Removal (Dkt. No. 1) established – and Plaintiffs concede – that all of the principal requirements for removal under CAFA are met here.

Plaintiffs now ask the Court to remand this class action to the Commonwealth Court pursuant to a narrow exception to CAFA, the so-called "local controversy" exception. To establish the applicability of that exception, however, Plaintiffs must prove by a preponderance of the evidence, among other things, that the "principal injuries resulting from the alleged conduct or any related conduct of each defendant were incurred in the State in which the action was originally filed." *i.e.*, in Puerto Rico. 28 U.S.C. § 1332(d)(4)(A).

Plaintiffs cannot make such a showing. Their simplistic contention that "there can be no doubt that the injuries were incurred in Puerto Rico" (Mot. at 7) betrays a deep misunderstanding of the "local controversy" exception, and to credit such assertion would require ignoring the broader context of this action. Indeed, while Plaintiffs purport to sue on behalf of a putative class of residents of Puerto Rico, Congress and relevant case law instruct that the makeup of the proposed class is secondary. Instead, the key issue is whether the alleged *conduct* at issue had effects beyond a particular locality. Here, Defendants' alleged conduct – specifically the creation and sale of billions of dollars of Puerto Rico municipal bonds – had consequences far beyond the shores of the Commonwealth, and in fact reverberated throughout the U.S. economy.

The gravamen of Plaintiffs' case revolves around what they claim to have been a house of cards: self-dealing Defendants supposedly "stood on all sides" of bond issuances and mutual fund transactions, knowingly dumped "toxic," high-risk debt into mutual funds that they marketed to seniors and retirees, and then stood idly by while the value of the underlying collateral (and secondarily the mutual funds themselves) plummeted, collecting management fees along the way. But the lynchpin of Plaintiffs' case is the first and most critical level of the alleged house of cards – the underlying Puerto Rico municipal bonds underwritten by certain of the Defendants, as well as several other global banking institutions. Because the principal injuries resulting from *that* alleged conduct were incurred well beyond Puerto Rico – indeed, throughout the United States – the "local controversy" exception does not apply, and the Court should deny the Motion.

BACKGROUND

On or about September 12, 2016, Plaintiffs commenced this putative class and shareholder derivative action against the Santander Defendants and Juan Carlos Batlle, Francisco Javier Hidalgo, Luis Roig, Román Blanco, Fredy F. Molfino, Fernando L. Batlle, Mario F. Gaztambide, Francisco Marrero-Meléndez, José E. Vázquez-Barquet, and Antonio Arias III (collectively, the "Director Defendants"). Plaintiffs purport to sue derivatively on behalf of a number of Puerto Rico closed-end investment funds (together, the "Funds"[1]) and also to represent a putative class of all persons who were clients of the Santander Defendants and who invested in the Funds and were damaged between March 1, 2012 through the present.

Plaintiffs' core theory is that the Santander Defendants created, controlled, managed, and advised the Funds, "loaded the Funds with . . . high-risk bonds they underwrote" (Puerto Rico-issued fixed-income securities), and knowingly failed to assess and/or mitigate the risks of investing in these "toxic" securities. *See* Dkt. No. 1-1, Complaint ("Compl.") ¶¶ 1, 8, 11. The Defendants allegedly generated millions of dollars in illicit fees "by performing various conflicting roles at every stage of the creation and management of the Funds," and "stood on all sides of the bond issuances and mutual fund transactions – as bond underwriter, investment advisor, and fund manager." *Id.* ¶¶ 7, 13. The Complaint emphasizes the allegedly outsize role played by the Santander Defendants in connection with underlying bonds, which were issued by the Commonwealth and its political subdivisions, organizations, agencies, and instrumentalities: it alleges that the Puerto Rico Sales Tax Financing Corporation ("COFINA") had 14 bond offerings from 2007 to 2011, ***12*** of which Santander Securities acted as lead or co-lead underwriter, underwriting *$15.3 billion* of $16 billion total. *See id.* ¶ 76. Likewise, Santander Securities allegedly served as underwriter of ***10** of the **15*** bond offerings by the Puerto Rico Government Development Bank ("GDB") between 2006 and 2012, or *$9 billion* out of the $11 billion total underwritten. *See id.* ¶ 77. Central to Plaintiffs' theory in this case is that Defendants, despite knowing the weakness of the investments, "purchased for the Funds the very

[1] The Funds are: First Puerto Rico Tax-Exempt Target Maturity Fund II, Inc.; First Puerto Rico Tax-Exempt Target Maturity Fund III, Inc.; First Puerto Rico Tax-Exempt Target Maturity Fund IV, Inc.; First Puerto Rico Tax-Exempt Target Maturity Fund V, Inc.; and First Puerto Rico Tax-Exempt Target Maturity Fund VII, Inc.

same Puerto Rico government bonds that they themselves had underwritten" – "[i]n other words, Defendants used the Funds as a dumping ground for the high-risk Puerto Rico debt they underwrote." *Id.* ¶ 83; *see also id.* ¶ 79.

According to the Complaint, Defendants' "illegal scheme" revealed itself in late 2012 when "the value of the Puerto Rico government bonds that Santander Defendants had underwritten and then plugged into the Funds began to decline – as concerns regarding the creditworthiness of the Puerto Rico government and rating agency downgrades intensified." Compl. ¶ 16. Defendants allegedly "stood idly and permitted these toxic holdings" – which they underwrote – "to remain in the Funds' portfolio," damaging investors in the Funds. *Id.* ¶ 17.

Plaintiffs' lawsuit is neither novel nor unique. They, like countless other investors all over the United States who invested in Puerto Rico debt securities, were allegedly damaged as a result of the massive and widely-reported collapse of the Puerto Rican municipal bond market.[2] And given the precipitous collapse in value of Puerto Rico municipal bonds, it is not surprising that investors in those securities – as well as investors in funds like those at issue here, with portfolios that include the bonds – have commenced litigation throughout the country, premised on many of the same facts and asserting the same claims as Plaintiffs do here. *See, e.g.*, Class

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[2] *See, e.g.*, Bill Faries, Martin Z. Braun, Michelle Kaske, *Puerto Rico's Borrowing Binge Could Rock the Muni-Bond Market*, BLOOMBERG BUSINESSWEEK (Oct. 31, 2013), http://www.bloomberg.com/news/articles/2013-10-31/puerto-ricos-borrowing-binge-could-rock-the-muni-bond-market ("The island's plight affects almost anyone with a mutual fund invested in the municipal-bond market. Exempt from local, state and federal taxes in the U.S., Puerto Rican bonds are held by 77 percent of muni funds"); Michelle Kaske, Martin Z. Braun, *Puerto Rico's Slide*, BLOOMBERG VIEW, (Feb 11, 2014), https://www.bloomberg.com/quicktake/puerto-ricos-slide (Noting that Puerto Rico's default "affects most people with a mutual fund invested in the municipal bond market" and that because "[u]nlike the bonds of most states and municipalities, Puerto Rico's are exempt from local, state and federal taxes everywhere in the U.S." as a result, "they are held by about half of open-end muni funds."); Tim McLaughlin, *U.S. Fund Managers Juggle Puerto Rico Debt, Redemptions and Rate Worries*, REUTERS, (Feb. 21, 2014), http://www.reuters.com/article/us-puertorico-funds-idUSL2N0LP2MK20140221 (Observing that Puerto Rico's default caused reverberations throughout the United States municipal bond market, resulting in $1.1 billion withdrawal from U.S. mutual bond funds with 5 percent or more exposure to Puerto Rico).

Action Complaint, *Pirinea v. Ambac Fin. Grp., Inc. et al.*, No. 16-cv-05076 (S.D.N.Y. June 28, 2016) (complaint alleging that defendant wrongfully obtained fees associated with sale of Puerto Rico municipal bonds and mislead nationwide class of investors as to the financial well-being of $2.5 billion invested in Puerto Rico securities); Class Action Complaint, *Fernandez et al v. UBS AG et al.*, No. 15-cv-02859 (S.D.N.Y. April 14, 2015) (class of nationwide investors in closed-end funds asserting claims for, *inter alia*, breach of fiduciary duties by defendants and subsidiaries based on fund investments in Puerto Rico municipal bonds and alleged undisclosed risks thereof).

Plaintiffs' claims here arise out of their ownership of common shares in the Funds, rather than direct ownership of the underlying bonds, and therefore the putative class is limited to residents of Puerto Rico. But the Complaint is principally focused on alleged *conduct* by Defendants – specifically the underwriting of massive amounts of bonds issued by the Commonwealth – that had wide-ranging consequences, and potentially affected investors nationwide.

ARGUMENT

I. Defendants Have Satisfied the Requirements for CAFA Removal

BSSA's Notice of Removal established that this Court has original jurisdiction over this action under CAFA because (1) there is minimal diversity, *i.e.*, at least one member of the putative plaintiff class is a citizen of a State different from any one defendant, (2) the number of putative class members exceeds 100, and (3) the aggregate amount in controversy exceeds the sum or value of $5 million exclusive of interests and costs. Dkt. No. 1 ¶¶ 8-16; *see also* 28 U.S.C. § 1332(d).

Plaintiffs ***concede*** that each of these criteria is met. *See* Mot. at 4 (stating that "Plaintiffs do not dispute" that BSSA satisfied Section 1332(d)).

II. Plaintiffs Bear the Burden of Proving that the "Local Controversy" Exception to CAFA Applies

Because BSSA made an initial showing that removal under CAFA is proper, this Court has original jurisdiction *unless* Plaintiffs can *prove* that one of the limited exceptions to CAFA jurisdiction applies. *See Coll. of Dental Surgeons of Puerto Rico v. Triple S Mgmt., Inc.*, 2011 WL 414991, at *1 (D.P.R. Feb. 8, 2011) ("*Coll. of Dental Surgeons*") (holding that the party seeking remand unmistakably bears the burden of proving, by preponderance of the evidence, application of an exception to CAFA) (citing *In re Hannaford Bros. Co. Customer Data Sec. Breach Litig.*, 564 F.3d 75, 78 (1st Cir. 2009)). This burden is a high one. In enacting CAFA, Congress distinctly intended exceptions to CAFA to be limited and narrow, with all doubts "resolved in favor of [the federal court] exercising jurisdiction over the case." S. Rep. No. 109-14 at 42 (2005); *see also* 151 Cong. Rec. H727 (daily ed. Feb 17, 2005) ("[CAFA's] provisions should be read broadly with a strong preference that interstate class actions should be heard in a Federal court if removed by any defendant.").

Here, Plaintiffs oppose federal jurisdiction on a single, narrow basis – they invoke the "local controversy" exception to CAFA. *See generally* Mot. at 4. To demonstrate that this exception applies, Plaintiffs must show that:

1) two-thirds of the proposed plaintiff class are citizens of Puerto Rico;
2) at least one defendant is a citizen of Puerto Rico, and whose conduct created a significant basis for Plaintiffs' claims, and from whom significant relief is sought;
3) the "principal injuries resulting from the alleged conduct or any related conduct of each defendant were incurred in the State in which the action was originally filed" (28 U.S.C. § 1332(d)(4)(A); *and*
4) no class action asserting similar factual allegations against any of the Defendants has not been filed in the preceding three years.

See Mot. at 4 (citing 28 U.S.C. § 1332(d)(4)); *see also Coll. of Dental Surgeons*, 2011 WL 414991, at *2.

Congress made clear that the exception was to have limited application. During the House's debate of the bill, the chairman of the House Judiciary Committee at the time offered into the record a "statement relative to the intent of the managers of the bill," with a detailed account of the "local controversy" exception:

> [T]his is a narrow exception that has been carefully drafted to ensure that it does not become a jurisdictional loophole. . . . [A] Federal court should bear in mind that the purpose of each of these criteria is to identify a truly local controversy—a controversy that uniquely affects a particular locality *to the exclusion of all others*. . . .

151 Cong. Rec. H728 (daily ed. Feb. 17, 2005) (emphasis added). With respect to the third necessary element – the "principal injuries" test – he further clarified the framer's intent:

> By [principal injuries], the Sponsors mean that all or almost all of the damage caused by defendants' alleged conduct occurred in the State where the suit was brought. The purpose of this criterion is to ensure that this exception is used only where the impact of the misconduct alleged by the purported class is localized. . . . [I]f the defendants engaged in conduct that could be alleged to have injured consumers throughout the country or broadly throughout several States (such as an insurance or product case), the case would not qualify for this exception, ***even if it were brought only as a single-State class action***.

Id. (emphasis added).

Adhering to these tenets, courts in this District and elsewhere uniformly have held that the "local controversy" exception is inapplicable where defendants engaged in conduct that could be alleged to have injured persons throughout the country, *even where the plaintiff class is limited to citizens of a single state*. *See, e.g.*, *Coll. of Dental Surgeons*, 2011 WL 414991, at *6 (denying remand motion brought by plaintiff class of Puerto Rico citizens, finding that alleged conduct potentially injured individuals throughout several states); *Marino v. Countrywide Fin.*

Corp., 26 F. Supp. 3d 949, 954 (C.D. Cal. 2014) ("courts have rejected the application of this exception when the conduct and injuries are alleged to be nationwide, even if the proposed class is limited to citizens of a single State"); *Waller v. Hewlett–Packard Co.*, 2011 WL 8601207, at *4 (S.D. Cal. May 10, 2011) ("Plaintiff's action is local only in the trivial and almost tautological sense that the definition of the putative class and the legal bases of the asserted claims make it so. Courts have routinely looked beyond these formalities—and looked to the nature and scope of the alleged wrong—and rejected a plaintiff's invocation of the local controversy exception that relies on them.").

Accordingly, regardless of the definition of the putative class, if the Complaint alleges that Defendants engaged in conduct that could have injured investors throughout several states, the "local controversy" exception does not apply and the Motion should be denied.

III. Plaintiffs Have Failed to Prove that the "Local Controversy" Exception Applies

Plaintiffs cannot establish that the "local controversy" exception applies here because the principal injuries resulting from Defendants' alleged conduct were *not* suffered by Puerto Rico citizens *alone*. Indeed, at the heart of this case are allegedly "toxic" and high-risk Puerto Rico municipal bonds *underwritten by certain of the Santander Defendants*, and sold to investors throughout the United States and beyond. Compl. ¶ 11. As Plaintiffs allege, "the value of the Puerto Rico government bonds that Santander Defendants had underwritten and then plugged into the Funds began to decline [] as concerns regarding the creditworthiness of the Puerto Rico government and rating agency downgrades intensified." Complaint ¶ 16. That precipitous decline in value is how and why Plaintiffs were allegedly damaged here, and unmistakably it sent shockwaves far beyond the shores of Puerto Rico. *See, e.g.*, n.2, *supra*. And while it is true that *the Funds* were marketed solely to Puerto Rico residents, to argue that this case concerns only the management of the Funds is to rob the allegations of their broader context. At the heart of

Plaintiffs' claims are allegations of self-dealing and conflicts of interest, and Defendants' use of the Funds as just one part of an alleged intricate and elaborate fraudulent scheme. *See, e.g.*, Compl. ¶ 80 ("Defendants' control over the Funds provided Defendants with a captive market and an immediate and controllable demand for the government debt offerings they had been underwriting for over a decade.").

The Court's decision in *College of Dental Surgeons of Puerto Rico v. Triple S Management, Inc.* is particularly instructive here. In that action, a plaintiff representing a putative class of Puerto Rico-resident dentists asserted claims arising from Defendants' alleged scheme designed to systematically deny, delay and decrease payments to dentists through manipulation of billing codes and various unfair business practices and contracts. *See Coll. of Dental Surgeons*, 2011 WL 414991, at *1. The plaintiff moved to remand the action to the Commonwealth Court because, among other bases, it claimed that the "local controversy" exception to CAFA jurisdiction applied. As is the case here, the Court reasoned that "[i]n essence, the adjudication of [the] motion to remand depends on whether 'principal injuries' should be confined to the injuries of the proposed class or include potential injuries to others." *Id.* at *2. After a thorough examination of CAFA, the Court denied the motion to remand and retained jurisdiction, holding that because the billing practices and contracts at issue were common to the defendants' dealings with dentists throughout the U.S., and could potentially be the basis for similar lawsuits elsewhere, the plaintiff had failed to establish the "principal injuries" prong. *See id.* at *6 ("in this case Plaintiff fails to offer a persuasive argument differentiating the injuries to the proposed class from the *potential injuries suffered outside of Puerto Rico.*") (emphasis added).

A similar analysis – and outcome – is warranted here. Plaintiffs' simplistic assertion that "because the Funds were offered only to Puerto Rico residents, there can be no doubt that the injuries were incurred in Puerto Rico" (Mot. at 7) betrays a misunderstanding of the "principal injuries" test, and it mischaracterizes the alleged relevant conduct. Like the billing practices at issue in *Coll. of Dental Surgeons*, the Santander Defendants' underwriting and sale of the bonds at issue – the first and most critical level of the alleged house of cards – led to losses suffered by thousands of investors throughout the U.S., not solely the investors in these Funds.[3] Where, as here, the alleged conduct "could be alleged to have injured consumers throughout this country or broadly throughout the several states" (S. Rep. 109-14 at 38), Congress and relevant case law mandate that CAFA's broad jurisdictional reach is not annulled merely because Plaintiffs seek relief on behalf of a class of Puerto Rico residents. *See Coll. of Dental Surgeons*, 2011 WL 414991 (D.P.R. Feb. 8, 2011); *Kearns v. Ford Motor Co.*, 2005 WL 3967998 (C.D.Cal. Nov. 21, 2005) (controversy not local when defendant "faces nationwide exposure" on theories similar to those alleged in class action complaint filed in state court); *Marino v. Countrywide Fin. Corp.*, 26 F. Supp. 3d 949, 955 (C.D. Cal. 2014) ("the alleged conduct—issuing loans—was national in scope [and] Plaintiff cannot meet his burden as to 'principal injuries' simply by focusing on California and ignoring other markets").

Because this case is not strictly a "local controversy" as that term is defined by CAFA, Plaintiffs' motion to remand must be denied.

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[3] *See, e.g.*, Christine Albano, *Muni Funds Slowly Shed Puerto Rico Debt*, THE BOND BUYER (Jul. 2, 2015) http://www.bondbuyer.com/news/markets-buy-side/muni-funds-slowly-shed-puerto-rico-debt-1078005-1.html ("As Puerto Rico teeters on default, *more than 50% of all U.S. open-end municipal bond funds* still have exposure to the island's debt"); Jason Kephart, *Oppenheimer's Risky Bond Bets Backfire – Again*, INVESTMENTNEWS (Oct. 11, 2013) http://www.investmentnews.com/article/20131011/FREE/131019966/oppenheimers-risky-bond-bets-backfire-again (commenting on heavy losses due to Puerto Rico bond holdings; "The S&P Municipal Bond Puerto Rico Index was down 21% year-to-date through Oct. 10 [2013]").

CONCLUSION

For all of the foregoing reasons, as well as the reasons stated in the Notice of Removal, the Court should retain jurisdiction of this action and deny Plaintiff's Motion to remand.

RESPECTFULLY SUBMITTED.

In San Juan, Puerto Rico, this 29th day of November, 2016.

WE HEREBY CERTIFY that on this date, we have electronically filed the foregoing with the Clerk of the Court using the CM/ECF system which will send notification of such filing to all attorneys of record.

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